

Master Thesis
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Unilateral Modification and Withdrawal of WTO Concessions and Commitments

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Table of Contents

TABLE OF REPORTS CITED	III
INDEX OF AUTHORITIES	VII
LIST OF ABBREVIATIONS	X
1. INTRODUCTION.....	1
1.1 Topic of the Thesis: <i>Unilateral</i> Modification of Commitments	1
1.2 The Provisions Permitting Unilateral Modification of Commitments.....	1
1.3 Outline and Method of the Thesis	3
2. TO WHAT DEGREE SHOULD WTO MEMBERS BE ALLOWED TO UNILATERALLY MODIFY THEIR COMMITMENTS?	4
2.1 Introduction.....	4
2.2 Principles Which Do Not Support Unilateral Modifications	4
2.2.1 The Security and Predictability of Market Access Commitments Does Not Support Unconditional Access to Unilateral Modification.....	4
2.2.2 The Principles of Negotiation and Multilateralism Do Not Support Unsanctioned Unilateral Modification	6
2.2.3 Raising Market Access Barriers is Not Economically Sound	6
2.3 Principles Supporting Unilateral Modification	7
2.3.1 Unilateral Modification May Be Necessary for Reasons of Political Economy.....	7
2.3.2 Flexibility Encourages Governments to Make Commitments	7
2.3.3 Unilateral Modification Provisions Allow Members to Avoid the Amendment Procedure	9
2.3.4 Development as a WTO Objective Influences the Access to Unilateral Modification	9
2.4 Principles Governing How Unilateral Modification Should Be Done and at What Price Modification Should Come.....	10
2.4.1 Reciprocity and Balance – More Political Economy	10
2.4.2 The Principle of Proportionality Should Govern the Extent of Reaction to Unilateral Modification	12
2.4.3 The Principle of Non-Discrimination Entails that Unilateral Modification Should Be Done on a MFN Basis	12
3. INTERPRETATION OF PROVISIONS PERMITTING UNILATERAL MODIFICATION OF COMMITMENTS.....	13
3.1 Introduction and Overview	13
3.2 Unilateral Modification of Commitments is an Absolute Right.....	14
3.3 Procedural Requirements Must Be Met before Unilaterally Modifying Commitments	16
3.3.1 Overview of Procedural Requirements	16
3.3.2 Modification May Only Be Done at Specific Time Intervals	17
3.3.3 Modification Must Be Preceded by Notification	19
3.3.4 The Modifying Member Must Consult or Negotiate with Categories of WTO Members.....	19
3.3.5 The Modifying Member May Have to Participate in Arbitration	22

	3.3.6 Unilateral Modification May Not Precede the Procedural Obligations	23
3.4	Certain Categories of Affected Members Have a Correlative Right of Response to Unilateral Modification	24
	3.4.1 Overview and Questions	24
	3.4.2 Which Members May Retaliate?	25
	3.4.3 To Which Degree May Members Retaliate?	26
	3.4.4 Against Which Members May Affected Members Retaliate?	27
4.	UNILATERAL MODIFICATION AND DISPUTE SETTLEMENT	30
4.1	Introduction	30
4.2	Retaliatory Modification and Retaliation in Dispute Settlement: Differences, Similarities and Consequences Thereof	31
4.3	Non-Violation and Retaliatory Modification	33
4.4	Modification in a Disputed Setting	34
5.	UNILATERAL MODIFICATION AND THE NATURE OF WTO COMMITMENTS AND OBLIGATIONS	35
5.1	Setting the Stage: The Compliance vs. Rebalancing Debate	35
5.2	The Right to Unilaterally Modify Commitments Does Not Change the Binding Nature of WTO Obligations	37
5.3	Are Market Access Commitments Binding?	40
5.4	Returning to the Stage: Concluding Remarks on Rebalancing and Compliance	43
6.	CONCLUSION	43

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LIST OF ABBREVIATIONS

AB	Appellate Body
Art.	Article or Articles
DS	Dispute settlement
DSB	Dispute Settlement Body
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
EC	European Communities
EEC	European Economic Community
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade 1994
GATT-47	General Agreement on Tariffs and Trade 1947
INR	Initial Negotiating Right(s)
MFN	Most Favoured Nation
ND	Non-Discrimination
PSI	Principal Supplying Interest
SI	Substantial Interest
SPS	Agreement on the Application of Sanitary and Phytosanitary Measures
TBT	Agreement on Technical Barriers to Trade
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights
US	United States of America
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization
WTOA	Marrakesh Agreement Establishing the World Trade Organization
WTO Agreements	The multilateral trade agreements included in Annexes 1, 2 and 3 to the Marrakesh Agreement Establishing the World Trade Organization

1. INTRODUCTION

1.1 Topic of the Thesis: *Unilateral Modification of Commitments*

International trade presupposes access to the domestic markets of other countries. In order to ensure secure, predictable and growing access to foreign markets, WTO members negotiate and bind tariff concessions for goods and commitments for services.¹ These are annexed in schedules to the GATT and the GATS, and form an integral part thereof.² The legal consequence of binding commitments is that WTO members may not raise market access barriers beyond the bound level.³ Yet, the consolidating of commitments does not tie the hands of members, as one might expect: Several WTO provisions permit members to modify or withdraw their commitments without violating their WTO obligations. While modification is primarily based on renegotiation, the prominent aspect of these provisions is that the member wishing to deviate from its commitments may do so, *even if* it is unable to secure permission from affected members. This aspect, which will be referred to as '*unilateral modification*', is the topic of the thesis.

1.2 The Provisions Permitting Unilateral Modification of Commitments

The GATT and GATS provide for a series of procedures to modify market access commitments, differing in scope and nature:⁴ Some allow temporary, others permanent modifications. Some may only be invoked if substantive conditions are met; others may be invoked independent of preconditions.⁵

The most central and far-reaching provisions permitting unilateral modification of commitments are Art. XXVIII GATT and XXI GATS. Modification pursuant to these provisions does not presuppose that material conditions are

¹ Hereinafter, GATT tariff concessions for goods and GATS market access commitments for services will be referred to with the common terms '*market access commitments*' or simply '*commitments*'. The term '*modification*' will hereinafter encompass both modification and complete withdrawal of a commitment. The WTO member wishing to modify or withdraw its bound commitment will be referred to as '*the modifying member*'.

² Art. II:7 GATT, XX:3 GATS. Schedules of concessions and commitments are therefore also part of the WTO "*covered Agreements*".

³ Art. II:1 (a) and (b) GATT, XVI GATS; *Argentina – Textiles and Apparel (AB)*, para. 46.

⁴ These procedures are only provided for in the GATT and GATS, due to the fact that other WTO agreements are unrelated to the idea of exchanging market access commitments, cf. section 5 below.

⁵ John H. Jackson, *World Trade and the Law of the GATT (1969)*, p. 229; Bernard M. Hoekman & Michel M. Kostecki, *The Political Economy of the World Trading System (2nd ed. 2001)*, p. 303.

met: Any commitment may be modified for any reason for an indefinite period of time.⁶

Art. XXIV:6 GATT and V:5 GATS also permit unilateral modification, and are of significant practical importance. They provide that the procedures of Art. XXVIII GATT and XXI GATS are to be followed if, in the formation or alteration of a regional economic integration area, market access barriers have to be raised beyond the bound level in one or more of the constituent territories.⁷

Another provision for unilateral modification of commitments is Art. XVIII:7 GATT. This is available for developing countries and may only be used for the purpose of promoting the establishment of a particular industry. Implicitly, the provision permits developing countries to proceed unilaterally: The developing country must make a reasonable effort to come to a negotiated solution, but ultimately no authorization from affected members is required.⁸

Furthermore, Art. XXVII GATT allows a member to unilaterally withhold or withdraw a commitment if the state with which the commitment was negotiated did not eventually become a member, or if it ceases to be one.

Finally, there is the general implied authority to correct errors through a process normally termed '*rectification*'.⁹

The safeguards clause, Art. XIX GATT and the Agreement on Safeguards, also provides for unilateral modification of commitments.¹⁰ In principle, measures under the general exceptions (Art. XX GATT and XIV GATS), the security

⁶ Warren F. Schwartz & Alan O. Sykes, *The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization*, 31 J. Legal Stud. 179 (2002), p. 186.

⁷ Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO: Procedure and Practices* (2001), p. 17. Modification is not done unilaterally by one member in this scenario, but one may still speak of unilateral modification because the regional economic integration area may modify its common commitments without the permission of affected members.

⁸ Hoda, *ibid.*

⁹ Jackson, *supra* note 5, at 230. There is no explicit authority in the GATT for rectification, while Art. XXI:5 GATS gives the Council for Trade in Services the competence to establish procedures for rectification. Correction of errors is, however, a process concomitant to any treaty and concerning which some customary international law exists. The practice is generally that the modifying member unilaterally rectifies the commitment, notifies all parties to this effect, and if no objections are received, the rectified commitment is effective.

¹⁰ Indeed, the language of Art. XIX GATT is very similar to that of Art. XXVIII GATT: "If agreement (...) is not reached, the contracting party which proposes to take or continue the action shall, nevertheless, be free to do so", see Art. XIX:3(a).

exceptions (Art. XXI GATT and XIV *bis* GATS), as well as anti-dumping measures, are taken unilaterally. An agreement with affected members is not necessary for invoking the measures. Nevertheless, these measures are conditional upon the existence of relatively strict substantive preconditions. Most are also inherently temporary. The thesis will be delimited to the provisions permitting unilateral modification for an indefinite period of time and independent of the existence of substantive preconditions. The unilateral aspect of temporary suspensions will therefore not be examined further.

1.3 Outline and Method of the Thesis

The objective of the thesis is to examine unilateral modification of WTO commitments from different perspectives and using different methods: Normative law, dogmatic legal interpretation, comparative methods and the political economy of law.

The thesis proceeds as follows: **Section 2** examines, from a *de lege ferenda* perspective, if and to what degree WTO members should be allowed to unilaterally modify their commitments. In particular, the section will highlight the objective and purpose of including unilateral modification provisions in the GATT and the GATS. Having established to what degree unilateral modifications should be permitted; the unilateral aspect of the principal modification provisions will be interpreted in **section 3**, thus illustrating how the contractual objects and purposes resonate in the text of the agreements. Section 3 aims at interpreting the principal provisions according to the rules of interpretation prescribed by Article 3.2 DSU. In **section 4**, issues concerning the relationship between unilateral modification and dispute settlement will be examined. The method will be contextual and comparative interpretation. Given that a WTO member may unilaterally modify its commitments, the legally binding nature of WTO obligations, in general, and market access commitments, in particular, has been questioned. This will be examined in **section 5**. Finally, **section 6** concludes.

Throughout the thesis, contract theory and concepts of political economics of law will be referred to. International political economy refers to interdisciplinary methods drawing upon law, economics and political science in explaining how international trade and state policies affecting international trade influence each other. A main theorem of the science is that governments are not necessarily the welfare-maximising entities found in economic theory, but develop policy subject to the pressure of a variety of interest groups.¹¹ Political economy therefore explains phenomena by using approaches beyond law and economics' standard methods.

2. TO WHAT DEGREE SHOULD WTO MEMBERS BE ALLOWED TO UNILATERALLY MODIFY THEIR COMMITMENTS?

2.1 Introduction

Principles, such as security and predictability, flexibility and reciprocity, may explain why and to what extent WTO members have agreed to permit unilateral modification of commitments.

The objectives and purposes of permitting unilateral modifications are manifold, and build partly on principles explicitly recognized in the WTO Agreements, partly on AB jurisprudence, and partly on considerations of economy and political economy.

A norm may arise from weighing different considerations and interests: Several principles do not support unilateral modifications, while others do. Some principles do not *per se* determine whether unilateral modifications should be permitted, but govern how unilateral modifications should be done and at what price such modification should come.

2.2 Principles Which Do Not Support Unilateral Modifications

2.2.1 The Security and Predictability of Market Access Commitments Does Not Support Unconditional Access to Unilateral Modification

The AB and panels often refer to the security and predictability of market access commitments. For instance, the AB agreed with the panel that:

¹¹ Hoekman & Kostecki, *supra* note 5, at vii.

[T]he security and predictability of "the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade" is an object and purpose of the WTO Agreement, generally, as well as of the GATT 1994.¹²

The AB in *US – Sunset Review* added that:

The GATT and the WTO, as well as the dispute settlement system, are intended to protect not only existing trade but also the security and predictability needed to conduct future trade.¹³

Considering the importance of security and predictability, unilateral modification of commitments should not be permitted, at least not unconditionally. If a member were free to unilaterally modify its commitments at any given time, the predictability for its trading partners and their economic operators would be significantly reduced.

On the other hand, even though a principle aim of the WTO is the protection of expectations, the WTO system does not concern itself with protecting expectations of a specific trade volume for a specific product or service.¹⁴ The AB has, concerning Art. III GATT, stressed that "*[it] protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products*".¹⁵ Hence, as long as mechanisms exist to ensure that the competitive relationship is not altered, unilateral modification of commitments may be permitted. This is precisely the way the provisions providing for unilateral modifications are structured.

The security and predictability of commitments may also be protected by other means than by prohibiting unilateral modifications. For instance, unilateral modification may be subjected to disciplining requirements like

¹² *EC – Computer Equipment (AB)*, para. 82. In *EEC – Panel on Newsprint*, the GATT panel "shared the view expressed before it relating to the fundamental importance of the security and predictability of GATT tariff bindings, a principle which constitutes a central obligation in the system of the General Agreement", cf. paras. 52-53.

¹³ *US – Sunset Review (AB)*, para. 82.

¹⁴ Chi Carmody, *A Theory of WTO Law*, Jean Monnet Working Paper 05/06, p. 12. The working paper is recently published in an edited version as an article, see Chios Carmody, *A Theory of WTO Law*, 11 *Journal of International Economic Law* 527 (2008). One may detect a change of orientation in panel jurisprudence towards the greater protection of economic operators, although this is still controversial, see *US – Section 301 Trade Act*.

¹⁵ *Japan – Alcoholic Beverages II (AB)*, p. 16; *Korea – Alcoholic Beverages (AB)*, para. 119; *Japan – Alcoholic Beverages (GATT panel)*, para. 5.11; *US – Superfund (GATT panel)*, para 5.1.9.

time-intervals of firm validity of commitments, notification requirements, duties of consultation and negotiation with affected parties.¹⁶

2.2.2 The Principles of Negotiation and Multilateralism Do Not Support Unsanctioned Unilateral Modification

It is commonly argued that the very essence of the world trading system consists of overcoming unilateral conduct in international trade relations.¹⁷ The principles of negotiation and multilateralism are inherent in the WTO and weaves through its agreements like a red thread. With regard to the settlement of disputes, the DSU explicitly precludes members from taking unilateral action.¹⁸ In this light, unilateral modification seems counterintuitive. However, a distinction must be drawn between unsanctioned unilateral behaviour and sanctioned unilateral behaviour which the members have agreed upon and incorporated in the WTO agreements: Although the measure itself is unilateral, the legal basis for it is multilaterally agreed. Even still, the modifying member should, according to the principles of multilateralism and negotiation, first enter into negotiation with a view to achieve a mutually agreed solution before resorting to unilateral modification.

2.2.3 Raising Market Access Barriers is Not Economically Sound

In economics, market access liberalization is a gain, even if done unilaterally. The world trade order is based on the economic theory of free trade, which teaches that all participating states profit from open trade, even if states unilaterally open their markets. From this *theoretical* viewpoint, it would be in the interest of states to abandon or lower trade barriers unilaterally, rather

¹⁶ However, one may consider these disciplining requirements as means to ease a transition to the changed commitments, rather than actually ensuring security and stability of said commitments.

¹⁷ Meinhard Hilf, *Power, Rules and Principles – Which Orientation for WTO/GATT-Law?*, 4 *Journal of International Economic Law* 111 (2001), p. 119, arguing that, “in general, unilateral measures need a specific justification under WTO law”.

¹⁸Article 23 DSU; *US – Certain EC Products (AB)*, para. 111; *US – Section 301 Trade Act (panel)*, para. 7.45; *EC – Commercial Vessels (panel)*, para. 7.207; Antonis Antoniadis, *Unilateral Measures and WTO Dispute Settlement: An EC Perspective*, 41 *Journal of World Trade* 605 (2007), p. 605.

than unilaterally raising them.¹⁹ Another rationale, beyond standard economics, must therefore underlie the unilateral modification provisions.

2.3 Principles Supporting Unilateral Modification

2.3.1 Unilateral Modification May Be Necessary for Reasons of Political Economy

Political economy maintains that governments do not strictly follow the rational recommendations following from free trade theory and do not necessarily aim at maximising overall national welfare. While liberalization of trade is beneficial for a national economy in its entirety, there are clear winners and losers among individual economic subjects.²⁰ Governments are not independent entities that can comply freely with economic insights. The decision-making process is influenced by respective interests of individuals, economic sectors and institutional and social groups.²¹

For reasons of political economy, therefore, a member might need to or be willing to redistribute wealth among its economic operators by sheltering some from international competition (this is the domestic result of a modification), while overexposing others to it (this is what compensatory commitments or retaliatory modification by affected members essentially amounts to).²²

2.3.2 Flexibility Encourages Governments to Make Commitments

A leading purpose for permitting unilateral modification of commitments is flexibility.²³ Although the WTO may be understood primarily as protecting

¹⁹ Peter-Tobias Stoll & Frank Schorkopf, *WTO – World Economic Order, World Trade Law* (2006), paras. 62 and 104. J. Michael Finger, *A Diplomat's Economics: Reciprocity in the Uruguay Negotiations*, 4 *World Trade Review* 27 (2005), p. 36. This is true when considering the economy of a state as a whole; economic theory of free trade does not address questions about the distribution of this prosperity or priorities of economic development.

²⁰ Stoll & Schorkopf, *supra* note 19 at para. 106.

²¹ Costs of liberalization are generally concentrated in specific industries, which are often well organized and oppose liberalization, whereas the benefits of liberalization usually accrue to a larger set of individuals who have no individual incentive to organize themselves politically. This is usually referred to as the theory of collective action, see Mancur Olson, *The Logic of Collective Action* (1977), cited by Stoll & Schorkopf, *supra* note 19 at para. 107.

²² Petros C. Mavroidis, *Trade in Goods: The GATT and the Other Agreements Regulating Trade in Goods* (2007) (hereinafter Mavroidis 2007), p. 98; Petros C. Mavroidis, *The General Agreement on Tariffs and Trade: A Commentary* (2005) (hereinafter Mavroidis: 2005), p. 88.

²³ Rüdiger Wolfrum et al., *WTO – Trade in Services* (2008), p. 468; Mavroidis (2007), *supra* note 22 at 98.

expectations concerning trade, it may also be conceived as aiming at facilitating adjustment to realities encountered in trade.²⁴

The WTO agreements are incomplete contracts between states. They cannot foresee or formulate conditional responses for all future contingencies. Changed circumstances and political reality will require adjustments to be made from time to time: Domestic policy may, for a variety of reasons, demand that some commitments be modified.²⁵

Flexibility serves the process of progressive liberalization.²⁶ Introducing flexibility by permitting unilateral modification of market access commitments will induce governments to make more meaningful commitments in the first place.²⁷ Kenneth W. Dam explains the rationale for including unilateral modification provisions in the GATT:

The GATT has a special interest in seeing that as many agreements for the reduction of tariffs as possible are made. Enforcement of bindings is important in the GATT insofar as such enforcement gives contracting parties the confidence necessary to rely upon tariff concessions offered by other contracting parties. But because of the economic nature of tariff concessions and the domestic political sensitivity inherently involved in trade issues, a system that made withdrawals of concessions impossible would tend to discourage the making of concessions in the first place. It is better, for example, that 100 commitments should be made and that that 10 should be withdrawn than that only 50 commitments should be made and that all of them should be kept.²⁸

Unilateral modification provisions therefore act as 'safety valves' encouraging significant reductions of trade barriers. Indeed, the provisions were considered essential as means of promoting liberalization.²⁹

²⁴ Carmody, *supra* note 14 at 3, 14. This was recognized by the panel in *Turkey – Textiles* when it pointed out that "[t]he WTO system of rights and obligations provides, in certain instances, flexibility to meet the specific circumstances of Members", cf. *Turkey – Textiles* (panel), para. 9.184.

²⁵ Finger, *supra* note 19 at 31.

²⁶ Mavroidis (2007), *supra* note 22 at 98; Wolfrum et al., *supra* note 23 at 468.

²⁷ Raj Bhala, *Modern GATT Law: A Treatise on the General Agreement on Tariffs and Trade* (2005), p. 318.

²⁸ Kenneth W. Dam, *The GATT: Law and International Economic Organization* (1970), p. 80; Kyle Bagwell & Robert W. Staiger, *The Economics of the World Trading System* (2002), p. 49. Dam's observation concerning the GATT remains even truer for market access commitments in services.

²⁹ Bagwell & Staiger, *supra* note 28 at 50. The Preparatory Committee noted that Article XXVIII:2 was included in order to "keep before us the objectives of the Charter to achieve a substantial reduction of tariffs, and, at the same time,

However, given the principles of security and predictability of commitments, flexibility should not necessarily entail permitting unilateral reduction of the *general* level of mutually advantageous commitments. Rather, flexibility should entail permitting members to liberalize trade according to their current and individual policy objectives and constraints as demanded by the present political economy.³⁰

2.3.3 Unilateral Modification Provisions Allow Members to Avoid the Amendment Procedure

A core advantage of the provisions permitting unilateral modification is that members do not have to invoke the somewhat cumbersome amendment procedure.³¹ Schedules of commitments are integral parts of the GATT and GATS. As such, without the modification provisions, they would have to be amended in accordance with Article X WTOA. Without the required consensus, members wishing to modify would have to resort to trade remedies, which are conditional and temporary. Worse yet, members would be reluctant to bind commitments in the first place.³²

2.3.4 Development as a WTO Objective Influences the Access to Unilateral Modification

Development, a fundamental objective of the WTO,³³ also influences members' access to unilateral modification. Although unilateral liberalization of market access commitments is generally considered to be beneficial to the members' economy, developing members are often reliant on trade barriers to generate state revenue. Thus, in order to secure the economic development in developing countries, access to unilateral modification of market access commitments should be greater for these members. In addition, similar to market access negotiations, developed members should

permit the necessary flexibility for withdrawing individual items as an alternative to complete withdrawal from the Agreement", see EPCT/TAC/PV/14, p. 32.

³⁰ Wolfrum et al., *supra* note 23 at 468.

³¹ *Ibid*; Hunter Nottage & Thomas Sebastian, *Giving Legal Effect to the Results of WTO Trade Negotiations: An Analysis of the Methods of Changing WTO Law*, 9 *Journal of International Economic Law* 989 (2006), p. 996.

³² Bhala, *supra* note 27 at 318. See section 2.3.2 about the advantages of flexibility.

³³ Preamble, WTOA, 2nd recital.

not expect reciprocity in renegotiation or retaliatory modification. These two considerations are reflected in Art. XVIII:7 GATT.

2.4 Principles Governing How Unilateral Modification Should Be Done and at What Price Modification Should Come

2.4.1 Reciprocity and Balance – More Political Economy

Even though unilateral market access liberalization in economic terms is a gain, WTO members view their market access commitments as costs which are warranted only when an offsetting benefit is obtained from reciprocal market access commitments by their trading partners. The WTO facilitates such mutually advantageous increases in market access on reciprocal basis and provides rules to secure them. At the same time, members are not held rigidly to their commitments, or the *level* of commitments implied by their negotiations. But they are held to the *balance* of commitments as a whole, to the equilibrium of benefits and concessions.³⁴

The principle of reciprocity, widely recognized as a pillar of the GATT,³⁵ is central to achieve and maintain the overall balance of commitments. The liberalization of world trade is pursued on the basis of reciprocity.³⁶ In principle, members incur no obligation to open up their markets unilaterally. Instead, the WTO counts on the mutual interest of the members in access to foreign markets.³⁷ Like the AB emphasized concerning negotiations: “[They] are a process of reciprocal demands and concessions, of ‘give and take’”.³⁸ Broadly construed, reciprocity refers to the idea of mutual changes in trade policy that bring about changes in the volume of each member’s import that are equal to the changes in the volume of its exports.³⁹

³⁴ The AB has condemned measures that “would fundamentally alter the overall balance of concessions Article XXVIII [GATT] is meant to achieve”, cf. *EC – Poultry* (AB), para. 101; *EC – Poultry* (panel), para. 215. The balance is not singular and static, but rather something that is in constant flux, see in an unrelated context *US – Shrimp*, para. 159. See also Kyle Bagwell & Petros C. Mavroidis & Robert W. Staiger, *It’s a Question of Market Access*, 96 *American Journal of International Law* 56 (2002), p. 59.

³⁵ Perhaps, at this stage, less so with regard to the GATS.

³⁶ Stoll & Schorkopf, *supra* note 19 at 38. Reciprocity is basic to any negotiation; the potential gain is what brings parties to the table, see Finger, *supra* note 19 at 29.

³⁷ Stoll & Schorkopf, *supra* note 19 at 38.

³⁸ *EC – Computer Equipment* (AB), para. 109.

³⁹ Bagwell & Staiger, *supra* note 28 at 55.

The concept of reciprocity does not, as such, give guidance as to whether unilateral modification of commitments should be permitted. Reciprocity is, however, a guiding principle in how unilateral modification should proceed and at what price it shall come. When market access barriers are being raised unilaterally or as part of renegotiation, reciprocity entails that the members involved should be permitted to reinstate the balance of commitments.⁴⁰ Without reciprocity, it is unlikely that unilateral modification would be condoned. It will be shown in section 3.4 that the provisions permitting unilateral modifications of commitments are some of the clearest expressions of reciprocity in the WTO. The provisions illustrate the idea that GATT and GATS to a large degree concern maintaining a level of reciprocally negotiated market access commitments; as long as members stay within a cooperative equilibrium, it is less material what the actual level of market access is for the specific product or service.⁴¹

From an economic point of view, the notions of reciprocity or balance, and thus unilateral modification and “retaliatory” modification, are paradoxical: The arbitrators in *EC – Bananas* recognized that “*the suspension of concessions is not in the interest of either [party]*”.⁴² It would be members’ best interest to abandon trade barriers unilaterally instead of unilaterally raising them. It is therefore also a paradox that a member affected by another member’s unilateral modification, will wish to reinstate the balance by raising its own market access barriers.⁴³ Like one commentator put it, “[i]f another country refuses to build more roads, the WTO allows you to tear up your own”.⁴⁴

Apparently, then, the rationale of reciprocity and unilateral modification must be found in political economy, and gain must be measured in *political*

⁴⁰ *Ibid.*

⁴¹ Mavroidis (2007) *supra* note 22 at 98.

⁴² *EC – Bananas* (Award of the Arbitrators), para. 2.13.

⁴³ Stoll & Schorkopf, *supra* note 19 at para. 104.

⁴⁴ David Yocis, *Hardened Positions: Guatemala Cement and WTO Review of Antidumping Determinations*, 76 *New York University Law Review* 1266 (2001), p. 1267, citing *Who Needs the WTO*, *Economist*, Dec. 4, 1999, at 74.

welfare.⁴⁵ Interestingly, reciprocity has a dual function in this regard: (i) Vis-à-vis the other members, reciprocity is a central element in the negotiation, operation and modification of commitments; but (ii) vis-à-vis the member's own domestic constituencies, reciprocity makes it easier to resist the exertion of the influence of interest groups that favour continued trade protection.⁴⁶

2.4.2 The Principle of Proportionality Should Govern the Extent of Reaction to Unilateral Modification

The principle of proportionality is closely connected to the principle of reciprocity. At its most abstract, proportionality entails that action undertaken must be proportionate to its objective. In case of unilateral modification, proportionality guides the extent to which affected members are permitted to respond, i.e. the response should not go further than what is necessary to reinstate the balance of commitments. Punitive retaliation would be disproportionate.

2.4.3 The Principle of Non-Discrimination Entails that Unilateral Modification Should Be Done on a MFN Basis

The principle of non-discrimination does not, as such, give guidance on whether unilateral modification should be permitted and, if so, to what degree. It does, nonetheless, play a role in the implementation of the actual modification: According to the MFN-principle, the modification must be done vis-à-vis all members and not discriminate against one or more members. A controversial question is whether retaliatory reaction to unilateral modification may be done on a MFN basis or only vis-à-vis the modifying member.⁴⁷

⁴⁵ Cf. section 2.3.1. Bernard M. Hoekman & Petros C. Mavroidis, *The World Trade Organization: Law, Economics and Politics* (2007), p. 18; Wolfgang Benedek, *Die Rechtsordnung des GATT aus völkerrechtlicher Sicht, Beiträge zum ausländischen öffentlichen Recht und Völkerrecht* (1990), p.54.

⁴⁶ Stoll & Schorkopf, *supra* note 19 at para. 108. Reciprocity will lead members affected by unilateral modification to retaliate, thus targeting another specific export-oriented domestic interest in the modifying member state. One could say that by giving reciprocal concessions, policymakers 'tie their hands to the mast of free(er) trade'.

⁴⁷ This will be assessed in section 3.4.4.

3. INTERPRETATION OF PROVISIONS PERMITTING UNILATERAL MODIFICATION OF COMMITMENTS

3.1 Introduction and Overview

Now that the contractual reasons behind unilateral modification have been examined, this section interprets provisions condoning unilateral modification of market access commitments. The interpretation is delimited to the two main provisions, Art. XXVIII GATT and XXI GATS. These provisions also apply to the formation or modification of regional economic integration areas by virtue of Art. XXIV:6 GATT and XXI GATS. Further, the interpretation is restricted to the unilateral aspects of these provisions; the multilateral routes have already been thoroughly examined by scholars.⁴⁸ The method utilized in this section is that prescribed by Article 3.2 DSU.⁴⁹

Art. XXVIII GATT provides for the possibility of unilateral modification of tariff concessions *after* negotiation and consultation with certain affected members, which are given a right to respond. There are three different routes of renegotiation, which all may lead to unilateral modification: (i) 'Three year' or 'open season' renegotiations under paragraph 1 and 2; (ii) 'reserved' renegotiations under paragraph 5; and (iii) 'special circumstances' renegotiation upon authorization under paragraph 4.⁵⁰

In the negotiations, the modifying member is expected to give compensatory commitments on other products. If agreement is not reached, the modifying member may proceed *unilaterally* and certain affected members may withdraw substantially equivalent commitments.

Art. XXI GATS provides for a similar procedure, but with two main differences: *Firstly*, GATS does not distinguish between different routes of renegotiation.

⁴⁸ See, *inter alia*, Bhala, *supra* note 27; Dam, *supra* note 28; Hoda, *supra* note 7; Jackson, *supra* note 5; Mavroidis (2007) *supra* note 22; GATT, *Analytical Index: Guide to GATT Law and Practice* (6th ed 1994), pp. 863-910.

⁴⁹ "[C]ustomary rules of interpretation of public international law", i.e. "the general rule of interpretation" set out in the Vienna Convention on the Law of Treaties, Articles 31 and 32, see *US – Gasoline (AB)*, p. 16 and *Japan – Alcoholic Beverages II (AB)*, para. 104. The ordinary meaning of the terms in their context and in light of object and purpose are the main parameters for the interpretation. If necessary, recourse may be had to supplementary means of interpretation, i.e. the preparatory work of the treaty and the circumstances of its conclusion.

⁵⁰ Bhala, *supra* note 27 at 327; Hoda, *supra* note 7 at 15.

Secondly, arbitration may be requested by affected members if no agreement is reached. The differences will be dealt with consecutively.⁵¹

3.2 Unilateral Modification of Commitments is an Absolute Right

Scholars have described the right to unilaterally modify commitments pursuant to Art. XXVIII GATT and XXI GATS as an “*absolute right*” provided that the prescribed procedure is followed.⁵² An absolute right is a right which is unqualified, and which cannot be denied or curtailed.⁵³

The exercise of the right does not depend on an agreement being reached with members which will be affected by the modification: It is expressly recognized in Art. XXVIII GATT that even if an agreement cannot be reached, the modifying member “*shall, nevertheless, be free [to modify or withdraw the concession]*”.⁵⁴ A member may or may not choose to exercise the right; it is not a benefit which the rest of the WTO members hold and allot to ‘lucky’ members as they see fit. Rather, it is a legal right of any individual member.⁵⁵

Moreover, the terms of the provisions do not qualify the right to unilaterally modify a commitment by any substantial prerequisites or requirements.⁵⁶ Art. XXVIII GATT and XXI GATS may be invoked independent of the occurrence of an agreed contingency (as opposed to the safeguards clause). The initiative to launch the process rests solely with the modifying member and perceived political expediency suffices (but is not required).⁵⁷

The words “*shall, nevertheless, be free to do so*” are found only in relation to renegotiation according to Art. XXVIII:3 and 5 GATT. Some scholars have therefore questioned whether there is a right to unilaterally modify

⁵¹ In general, the differences between the GATT and GATS may be explained by the different objects of regulation and, thus, the different regulatory aims and structures, in addition to practical experience. For instance, trade barriers for services are mostly of a *regulatory* nature. Service liberalization is, moreover, a *socially sensitive issue* and the level of liberalization is low. Political economy will therefore require more flexibility to encourage liberalization. Finally, the historical alignment with the negotiation of the DSU may have had an impact on Art. XXI GATS.

⁵² Jackson, *supra* note 5 at 231; Hoda, *supra* note 7 at 16.

⁵³ Black’s Law Dictionary (8th edition), p. 1347. A relative right, on the other hand, is a right that arises from and depends on someone else’s right.

⁵⁴ Art. XXVIII:3(a) GATT.

⁵⁵ Bhala, *supra* note 27 at 320.

⁵⁶ Jackson, *supra* note 5 at 231.

⁵⁷ Mavroidis (2007) *supra* note 22 at 98.

commitments following the special circumstances renegotiation pursuant to Art. XXVIII:4(d) GATT. This paragraph dictates in its third sentence that the modifying member shall be free to unilaterally modify its commitment “*unless the CONTRACTING PARTIES determine that [the modifying member] has unreasonably failed to offer adequate compensation*”. The ordinary meaning of the terms suggests that the WTO members may veto or block a unilateral modification under the special circumstances renegotiation. Indeed, this has led scholars to conclude that unilateral modification is not an option under Art. XXVIII:4 GATT.⁵⁸

That view is not sustainable. It fails to take the immediate context into account. The next sentence reads “[*if such action is taken*”, i.e. if the modifying member proceeds despite the CONTRACTING PARTIES judging that it had unreasonably failed to offer adequate compensation, affected members “*shall be free (...) to modify (...) substantially equivalent concessions*”. When read in its entirety, Art. XXVIII:4 GATT does not prohibit unilateral action; rather, it qualifies when affected members may retaliate: Unreasonable failure by the modifying member to offer adequate compensation is the standard or determining when affected member have the right to retaliate, and *not* whether the modifying member may proceed unilaterally. The WTO members cannot block such behaviour.⁵⁹

Art. XXVIII:4 GATT may nevertheless still be viewed as a multilateral option: Given that authorization is required before the modifying member can enter into negotiation, the authorization must be granted by a consensus decision,

⁵⁸ Jackson, *supra* note 5 at 235. The original GATT-47 contained no provision allowing for the special circumstances renegotiation. Various GATT parties appealed to the CONTRACTING PARTIES for special dispensation to renegotiate and were generally granted the right to do so. The procedures were termed analogous to Art. XXVIII, except that, due to the unanimity requirement, all members had a chance to participate. The so-called ‘sympathetic consideration’ for renegotiation in ‘special circumstances’ was always granted at that time, reflecting the fact that the GATT was (and still is) an unfinished agreement, and that the CONTRACTING PARTIES generally recognized the need for greater flexibility. Art. XXVIII was ultimately renegotiated in 1954 to include the special circumstances renegotiation. Unilateral withdrawal was *not* permitted if renegotiations were unsuccessful under the ‘sympathetic considerations’ regime that Article XXVIII:4 replaced.

⁵⁹ Bhala, *supra* note 27 at 336-337; Mavroidis (2007), *supra* note 22 at 111. According to Bhala, “*what the last clause (...) does is eliminate the freedom of the applicant to act with impunity*”. The term impunity gives association to criminal law, and is, perhaps, not entirely fitting. Bhala reads the clause from the modifying member’s side, whereas I view the clause from the affected member(s)’ side, simply because it adds conditionality to their right of retaliatory modification.

and the agreement of potentially negatively affected members is necessary to reach consensus, it is likely that negotiations on compensation effectively take place *before* authorization is granted.⁶⁰

It has also been questioned whether modifying members are barred from acting unilaterally after arbitration pursuant to Article XXI:4 GATS. Subparagraph (a) provides that “[t]he modifying Member may not modify or withdraw its commitment until it has made compensatory adjustment in conformity with the findings of the arbitration”. The ordinary meaning of the terms suggests that they limit the freedom to unilaterally modify commitments, in the sense of eliminating it entirely, unless the modifying member abides by the arbitration award regarding compensation.

Again, the immediate context suggests another understanding of the provision: According to subparagraph (b), “[i]f the modifying Member implements its proposed modification or withdrawal and does not comply with the findings of the arbitration, any affected Member that participated in the arbitration may modify or withdraw substantially equivalent benefits”. When both subparagraphs are read together, they determine when affected members may retaliate; they do not block the modifying member from acting unilaterally.⁶¹

Accordingly, in all routes of renegotiation provided by Art. XXVIII GATT and XXI GATS, save perhaps for the GATT special circumstances renegotiation, the modifying member has the unequivocal freedom to proceed unilaterally with its modification.

3.3 Procedural Requirements Must Be Met before Unilaterally Modifying Commitments

3.3.1 Overview of Procedural Requirements

Like most rights, the right of a WTO member to unilaterally modify its commitments is not without its attendant responsibilities. Although the wish for

⁶⁰ Mavroidis (2007), *supra* note 19 at 111.

⁶¹ The implementing procedures suggest the opposite, see S/L/80, *Procedures for the Implementation of Article XXI of the General Agreement on Trade in Services*, adopted by the Council for Trade in Services 19 July 1999, para. 9.

flexibility has led to WTO members condoning unilateral modification of commitments without having to fulfil substantive or material requirements, the wish for security and predictability of market access commitments, as well as the principles of multilateralism and negotiation, require that unilateral modification be subjected to structuring disciplines of procedural nature.

To that effect, the provisions permitting unilateral modification set out the following procedural responsibilities: (i) Modification may only be done at given time intervals or upon authorization; (ii) modification must be preceded by notification; (iii) certain categories of WTO members must be consulted or negotiated with; and (iv) the modifying member may have to enter into arbitration with affected members.

3.3.2 Modification May Only Be Done at Specific Time Intervals

If members were free to modify their commitments at any given time, legal certainty and predictability would be compromised.⁶² The modification provisions therefore contain various time intervals and deadlines within which modifications must be done.

With regard to service commitments, in order for modification to be commenced, at least “*three years*” must have elapsed from the date of the entry into force of the commitment.⁶³ In other words, GATS commitments have a firm validity of three years. A shorter period would have a negative impact on the sustainability of trade in services and the liberalization thereof.⁶⁴

After three years have lapsed from the entry into force of a given commitment, however, a member shall be free to modify it “*at any time*”.⁶⁵ The firm validity of the commitment is therefore not automatically renewed. Thus, flexibility seems to be prioritized over security and predictability. As will be shown, the members have agreed on less flexibility for goods. The reason

⁶² Bhala, *supra* note 27 at 332-333.

⁶³ Art. XXI:1(a).

⁶⁴ Wolfrum et al., *supra* note 23 at 468-469. Wolfrum et al. note that although the purpose of Art. XXI is to provide flexibility to react to economic/political changes, it is not meant to “*give a power immediately to open the next round of negotiation starting from a new status quo*”.

⁶⁵ Art. XXI:1(a) GATS.

for the difference *may* be that the level of liberalization of services is at a more rudimentary level than for goods. As argued above, flexibility is indispensable in securing further liberalization, cf. section 2.3.2.

In Art. XXVIII GATT, the relevant language is more intricate. Essentially, the three different routes of renegotiation provide for different periods of time in which modifications are permitted:

- (i) For 'three year' renegotiations, modifications may be done on "*the first day of each three year period*", the first of which began 1 January 1958, the last of which began 1 January 2009.⁶⁶
- (ii) For 'reserved' renegotiation, modifications may be done during the three year period referred to above if the modifying member has, before the beginning of the period, elected to reserve the right to renegotiate.⁶⁷
- (iii) For 'special circumstances' renegotiation, modifications may be done "*at any time*" in special circumstances upon the authorization by the CONTRACTING PARTIES.⁶⁸

In principle, GATT commitments have three-year periods of firm validity that are automatically renewed, thus serving the security and predictability of market access commitments. The 'special circumstances' and 'reserved' renegotiations provide exceptions, resonating the importance of flexibility.⁶⁹ Predictability is still preserved, though: It is the WTO members which decide whether 'special circumstances' renegotiations should be authorized⁷⁰ and 'reserved renegotiations' give potentially affected members timely warning that modification may occur during the next three year period. This option is, moreover, only a tool for far-sighted members, i.e. those members

⁶⁶ Art. XXVIII:1 and 2 GATT. Records of renegotiations are so far not publicly available.

⁶⁷ Art. XXVIII:5 GATT.

⁶⁸ Art. XXVIII: 4 GATT.

⁶⁹ The Review Session Working Party Report resulting in the present text of Art. XXVIII noted that "*the Article should provide for the extension of the firm validity of the schedules by three-year periods, but with greater flexibility in the right to renegotiate and in the procedures for renegotiation (...) during the periods of firm validity*", see L/329, adopted 26 February 1955, 3s/205, 217, para. 27 (iii) (emphasis added).

⁷⁰ Although, as argued above, once the authorization is given, the modifying member may proceed even without an agreement on compensation with affected members.

anticipating the possible need to revisit a bound market access commitment.⁷¹ Members increasingly reserve the right to renegotiate, even though a need for renegotiations might not be in sight. Concern has justly been raised about the insecurity of tariff bindings that this may lead to.⁷²

3.3.3 Modification Must Be Preceded by Notification

Members wishing to modify a commitment must notify the WTO. Art. XXI:1(b) GATS provides that “[a] modifying Member shall notify its intent to modify or withdraw a commitment (...) to the Council for Trade no later than three months before the intended date of implementation”. There is no similar wording in Article XXVIII GATT, but the *Ad Article XXVIII paragraph 1* note requires that “no earlier than six months, nor later than three months, (...) a contracting party wishing to modify or withdraw any concession (...) should notify the CONTRACTING PARTIES to this effect”.⁷³ A requirement of notification is also *de facto* implicit in the requirement to consult or negotiate with certain categories of WTO members.

3.3.4 The Modifying Member Must Consult or Negotiate with Categories of WTO Members

The procedural obligations owed to other members and the affected members' correlative right of response vary according to different categories of WTO members. In short, obligations are owed to the members which will suffer the most from the modification.⁷⁴

In the GATS, the procedural obligations are put in simple terms: The modifying member must “enter into negotiations with a view to reaching agreement on any necessary compensatory adjustment” with any member which “may be affected”.⁷⁵ This duty arises only “[a]t the request” of an affected member. The term “affected Member” is neither quantitatively nor qualitatively

⁷¹ Bhala, *supra* note 27 at 335.

⁷² GATT *Analytical Index*, *supra* note 48 at 883, citing a Secretariat Note for the Committee on Tariff Concessions.

⁷³ *Annex I, Notes and Supplementary Provisions, Ad Article XXVIII paragraph 1*, nr. 3. The *ad notes* contained in Annex I to the GATT are made an integral part of the GATT by virtue of Art. XXXIV GATT.

⁷⁴ Mavroidis (2007), *supra* note 22 at 102.

⁷⁵ Art. XXI:2(a) GATS. Any member which may be affected is referred to in Art. XXI GATS as an “affected Member”.

qualified. WTO Members to which an obligation of negotiation is owed must not *actually* be affected. It suffices for the obligation of negotiation to arise that the requesting member “*may*”, i.e. *potentially*, be affected by the modification. In comparison with the GATT, where the modifying member will only have to negotiate with a select group of members, renegotiation in the GATS is ‘multilateralized’.⁷⁶

The terms of the equivalent GATT provisions are yet again far more intricate. For the purpose of renegotiation and unilateral modification of GATT commitments, WTO members have been divided into the following categories: The modifying member; members having initial negotiating rights (“*INR*”); members having a principal supplying interest (“*PSI*”); and members having a substantial interest (“*SI*”) in the commitment.⁷⁷ In addition to these categories, the following categories of members may be identified: Members which are affected but do not have an *INR*, *PSI* or a *SI*, and members which are not affected by the modification at all. The latter two categories are not given rights according to Art. XXVIII GATT.

To WTO members with initial negotiating rights and principal supplying interest, the modifying member owes “*negotiation*”. To WTO members with substantial interest, it owes “*consultation*”.⁷⁸ The precise difference between the terms is not clear. The ordinary meaning suggests, however, that consultation does

⁷⁶ Matsushita et al., *The World Trade Organization, Law, Practice, and Policy* (2nd edition), p. 674.

Two reasons may explain this difference between the GATT and GATS: *Firstly*, the concept of negotiating rights could not be instituted in the GATS, at least in the beginning, because there was no reliable and comparable information on trade flows, which is the basis of negotiating rights in the GATT. In other words, there was no basis for identifying the members which will suffer most. *Secondly*, market access commitments on the liberalization of trade in services are modest. Thus, even though there are few limitations on which members that must be negotiated with, it is not likely that this will unduly delay the right to modify commitments.

⁷⁷ Art. XXVIII GATT. The categories have been thoroughly explained by several scholars, see, *inter alia*, Mavroidis (2007), *supra* note 22 at 98-102; Hoda, *supra* note 7 at 12-14; Bhala, *supra* note 27 at 320-326; Jackson, *supra* note 5 at 230-233.

For the purposes of this thesis, it suffices to note that a member has an *INR* if it has originally negotiated the specific commitment with the modifying member. Due to changes in the modes of tariff negotiations from the bilateral *request-and-offer* approach to *linear* and *sector* approaches, the CONTRACTING PARTIES have previously decided that any member with a *PSI* should be deemed to hold an *INR*. A member with a *PSI* is a member which has had a larger share in the market of the modifying member than the members with an *INR*. A member may also be deemed to have a *PSI* if the concession in question affects trade which constitutes a major part of the local exports. An understanding adopted in the Uruguay Round defines a member with a *PSI* as the member which has the highest ratio of exports affected by the concession. Members with a *SI* have a significant share in the market of the modifying member. In practice, members having 10% or more of the market of the modifying member have been considered as having a *SI*.

⁷⁸ Art. XXVIII:1 GATT.

not entail a session of give-and-take, as one may expect in negotiations.⁷⁹ The end effect is not very different if a member unilaterally modifies its commitments following consultation and negotiation: All three categories are accorded a right of retaliatory modification. Members which are affected, but do not have INR, PSI or SI, are not accorded any right to be consulted or negotiated with.

The reason for providing the participation of members with principal supplying interest in addition to members having initial negotiating rights is explained in the *Ad Article XXVIII paragraph 1* to the GATT, balancing the concepts of security and flexibility:

The object (...) is to ensure that a contracting party with a larger share in the trade affected by the by the concession than a contracting party with which the concessions was originally negotiated shall have an effective opportunity to protect the contractual right which it enjoys under this Agreement. On the other hand, it is not intended that the scope of the negotiations should be such as to make negotiations and agreement unduly difficult.⁸⁰

The original text of Article XXVIII GATT left it to the CONTRACTING PARTIES to determine which member had negotiation rights.⁸¹ According to the negotiating history, the purpose was to:

limit the right of other countries to hold up or delay or prevent the withdrawal or modification of the Schedule... any country can claim that it has an interest in any item in a Schedule, and if they wish to be difficult, it would be possible for them to hold up a modification of the Schedule by claiming an interest in a commodity, their interest in which was exceedingly remote... the obvious thing to do was to give the right of decision to the CONTRACTING PARTIES... and you could get on with the business.⁸²

⁷⁹ Bhala, *supra* note 27 at 328: "Exchanging information, ideas and possibilities generally is the focus of a consultation, while bringing about an arrangement is the goal of a negotiation".

⁸⁰ Interpretative Note *Ad Article XXVIII paragraph 1* GATT, para 4.

⁸¹ The present text of Art. XXVIII GATT was drafted during the Review Session of 1954-1955. The amendments came into effect on 7 October 1957.

⁸² EPCT/TAC/PV/14, p. 14-15, discussing proposal in EPCT/W/326, cited in *Analytical Index*. The limitation of negotiation to only members having INR and PSI ensures the *efficiency* of the right to modify commitments.

The negotiating history confirms that the right of modification is an absolute right, not to be unduly delayed, and also explains why the GATT today limits negotiation rights to certain categories of WTO members.

The negotiation and consultation is guided by an overarching principle that the members concerned “*shall endeavour to maintain a general level of reciprocal and mutually advantageous concessions [commitments] not less favourable to trade*”.⁸³

3.3.5 The Modifying Member May Have to Participate in Arbitration

The main difference between modification of the GATT and the GATS is that for services, if agreement on compensatory adjustment cannot be reached, the matter may be referred to arbitration.⁸⁴ It follows from the structure of Art. XXI GATT that if a timely request for arbitration is submitted, the modifying member should not modify its commitment until it receives the arbitrator's findings.⁸⁵ If there is no request for arbitration, the modifying member shall be free to implement the modification.⁸⁶ It is vital that any member wishing to enforce a right to retaliatory withdrawal participates in the arbitration – or else its right to retaliate is precluded.⁸⁷ A major reason for including arbitration in the GATS is that one may avoid situations where panels will be called to judge whether the compensation offered was adequate or not.⁸⁸

⁸³ Art. XXVIII:2 GATT and XXI:2(a) GATS.

⁸⁴ Art. XXI:3(a) GATS.

⁸⁵ S/L/80, *supra* note 61 at para. 9; Wolfrum et al., *supra* note 23 at 471.

⁸⁶ Art. XXI:3(b) GATS. An example of this was EU's enlargement from 15 to 25 member states: Agreement was reached with several affected members, but not with others. However, no WTO members referred the matter to arbitration and, accordingly, the EC were free to modify their commitments.

⁸⁷ Art. XXI:3(a) and 4(b) GATS. However, if an affected member has reached an agreement with the modifying member prior to arbitration and decides not to participate in the arbitration, it shall be deemed to have participated, see S/L/80, *supra* note 61 at para. 12.

⁸⁸ Matsushita et al., *supra* note 76 at 674. Arguably, one may also avoid calling on a panel to judge whether retaliation was “*substantially equivalent*” to the modification.

A further reason may be the fact that Art. XXI essentially leaves it to the modifying member to accept or reject a claim for loss of trade and consequent compensation (as compared to Art. XXVIII:1 GATT, where the CONTRACTING PARTIES may determine that a member has a PSI or SI). A process of arbitration therefore prevents arbitrary behavior on the part of the modifying member.

3.3.6 Unilateral Modification May Not Precede the Procedural Obligations

In all GATT and GATS renegotiation procedures, unilateral modification of market access commitments is not to precede the required time-intervals, notification, consultation/negotiation and potential arbitration.⁸⁹

The legal basis for this conclusion is three-fold: *Firstly*, the wording of both Art. XXVIII GATT and XXI GATS implies a specific order in which the modifying member must proceed. For instance, in Art. XXI GATS, paragraph 1 requires notification; paragraph 2 – negotiations; paragraph 3 – arbitration; and paragraphs 3(b) and 4 provide the legal basis for unilateral action. The three routes in GATT also imply a procedure of cooperation to be tried before unilateral modification, reflecting the principles of multilateralism and negotiation.⁹⁰

Secondly, the 1947 Geneva Preparatory Conference negotiation history supports, at least with regard to ‘three year’ renegotiations, that there is a need to defer withdrawal until after consultations and negotiations: “[t]he intention is... that consultation shall precede the withdrawal of the concession... The action will not be taken first and consultation later”.⁹¹

Thirdly, the GATT panel in *EEC – Bananas III* observed that:

[A]ccording to Article XXVIII:5, a notification of the intention to modify a tariff binding, by itself, does not change the legal status of that binding. Article XXVIII:1, to which Article XXVIII:5 refers, stipulates that the modification or withdrawal may occur only after negotiation with other relevant contracting parties.⁹²

In practice, modification of commitments has generally been implemented after concluding negotiations with affected members, whether successful or

⁸⁹ Bhala, *supra* note 27 at 328-329.

⁹⁰ Permitting deviation of the procedures would render parts of the provisions somewhat meaningless. This would not conform to the interpretative principle of effectiveness: One of the corollaries of the general rule of interpretation of Article 31 of the VCLT is that interpretation must give meaning and effect to all the terms of the treaty. One may not adopt an interpretation which would result in reducing clauses or paragraphs of a treaty to redundancy or inutility, see *US – Gasoline (AB)*, pp. 18, 21; *Korea – Dairy (AB)*, para. 81; Van den Bossche, *The Law and Policy of the World Trade Organization* (2nd edition 2008), p. 203.

⁹¹ EPCT/TAC/PV.14 at p. 13-19 (1947), cited in *Analytical Index*, *supra* note 48 at 867.

⁹² *EEC – Bananas III* (GATT panel), para. 133 (emphasis added). The panel was therefore required to examine the consistency of the new specific tariffs for bananas with Art. II GATT, notwithstanding the fact that the EEC had notified that it wished to modify the tariffs under Art. XXVIII:5 GATT.

not. However, there have been some cases in which the modifying member proceeded unilaterally after renegotiation had been concluded with most but not all members concerned, or in which renegotiations had been in progress but no agreement had been reached. It seems that the WTO members have been pragmatic regarding the time-limits and chronology for renegotiations.⁹³ In a limited number of cases, the commitment was modified even before the process of renegotiation had commenced. In these cases, obligations towards the relevant categories of members have not been observed. While none led to dispute settlement, some led to retaliatory or threatened retaliatory modifications. Arguably, additional dispute settlement for the violation of affected members' procedural rights would be of little value, since the obligations' disregard would likely only trigger compensation or retaliatory modification, something the modifying member would have to take into account anyway.⁹⁴

3.4 Certain Categories of Affected Members Have a Correlative Right of Response to Unilateral Modification

3.4.1 Overview and Questions

The right to unilaterally modify a market access commitment comes at a price. The essential aim of the procedure is to reach an agreement on necessary compensatory adjustment, not in monetary terms but by replacing the commitment withdrawn with another. If agreement cannot be reached and the modifying member proceeds unilaterally, certain affected members have a correlative right of response.

The right to respond permits categories of affected members to modify "substantially equivalent" market access commitments.⁹⁵ In confrontational

⁹³ In a meeting of the Committee of Tariff Concessions it was stressed that "a number of Article XXVIII negotiations had become rather protracted... in some circumstances, it might be necessary to proceed with the implementation of tariff changes for domestic reasons, before negotiations had been formally concluded, but it should not prevent the parties from continuing their efforts to reach an agreed settlement", see *Analytical Index*, supra note 48 at 884.

⁹⁴ Hoda, supra note 7 at 92. Today, it may be questioned whether such retaliation violates Art. 23.2(a) DSU. This provides that members shall not make a determination to the effect that a violation has occurred, except through recourse to dispute settlement.

⁹⁵ Art. XXVIII:3 and 4 GATT, XXI:4(b) GATS.

terms, this last resort of affected members is to retaliate.⁹⁶ In softer terms, the affected members are given the right to modify their commitments in order to re-establish the economic equilibrium and the competitive relationship, as suggested by the principle of reciprocity.⁹⁷

Three questions arise with regard to retaliatory modification: *Firstly*, which members may retaliate? *Secondly*, to what degree may members retaliate? *Finally*, against which member(s) may retaliatory modifications be targeted – only the modifying member or all WTO members?

3.4.2 Which Members May Retaliate?

In the GATS, all “*affected Members*” which have “*participated in the arbitration*” have the right to retaliate, whether or not they have initially negotiated the commitment with the modifying member. The wording does not distinguish between categories of members; nor does it qualify to what degree members must be affected or the affected members’ relation to the modified commitment. A member merely needs to demonstrate that it is “*affected*” in some way or another.⁹⁸

For a member to retaliate to a modification of GATT commitments, two conditions must be met: *Firstly*, the affected member must have an INR, PSI or SI in the commitment.⁹⁹ The distinction between the three categories is only relevant for the requirement of consultation or negotiation. It could be that other members are also affected by the unilateral modification. This raises the question of whether they are entitled to react. The terms of Art. XXVIII GATT do not acknowledge a right to retaliate for members not falling within the listed categories, even if they are affected to a significant degree. Such members therefore need to rely on the right to raise non-violation complaints against

⁹⁶ Bhala, *supra* note 27 at 330.

⁹⁷ The *travaux préparatoires* explains the motivation for including the right to retaliate: “If we wish to take an item out of our schedule then clearly it is fair and proper that the countries with whom we negotiate should be free to make the corresponding change in their schedules in order to restore the balance... but we want any such exercise to be limited to what is corresponding and not to be used in a punitive way”, see EPCT/TAC/PV/14, p. 20.

⁹⁸ The differences between the GATT and the GATS probably reflect the practical GATT experience, where affected members have retaliated even if they did not fulfil the rather restrictive wording, see below.

⁹⁹ See Section 3.3.4 and footnote 77 for explanation of the categories INR, PSI and SI.

the modifying member. This solution seems warranted given that the modifying member has the *right* to unilaterally modify its commitments; hence, its behaviour cannot be deemed a *violation*.¹⁰⁰

Secondly, in addition to the requirement that the affected member must have an INR, PSI or SI, only commitments “*initially negotiated*” with the modifying member may be withdrawn.¹⁰¹ An ordinary meaning of the terms suggests that if affected members do not have any commitments initially negotiated with the modifying member, they lose the right to retaliate. Practice indicates that affected members increase tariffs in retaliation, irrespective of whether the tariff concession was initially negotiated with the modifying member.¹⁰² Although such practice conflicts with the explicit wording of Art. XXVIII GATT, no formal challenge against it has yet taken place. The practice suggests, then, that this condition has been *de facto* relaxed. While it is unlikely that the WTO panels of the AB will neglect the explicit wording of the provisions in case of a dispute, several reasons suggest that the “*initially negotiated*”-requirement should not be interpreted strictly: In particular, the modes of negotiation have been significantly altered and the requirement may lead to very unreasonable results.

3.4.3 To Which Degree May Members Retaliate?

The affected members may withdraw “*substantially equivalent*” commitments. Given that the term “*equivalent*” is qualified by the term “*substantially*”, the market access commitments modified in retaliation do not need to be of equal value of the modified commitment. This is recognition of the fact that calculating the exact value of a commitment is a difficult task.

Art. XXVIII GATT does not further specify the nature of a retaliatory modification. In the GATS, however, more direction is given: Any affected member which participated in the arbitration may modify substantially

¹⁰⁰ Mavroidis (2007), *supra* note 22 at 109.

¹⁰¹ Art. XXVIII:3 (a), (b), 4(d), 5.

¹⁰² *Canada/EC – Article XXVIII Rights* (note that the dispute did not address whether this was in conformity with the GATT); Mavroidis (2007), *supra* note 19 at 105-106.

equivalent benefits “in conformity with those findings [i.e. the arbitrator’s award]”.¹⁰³

Guidance to the term “substantially equivalent” in GATT is found in *Ad Article XXVIII paragraph 1* (concerning renegotiation):

It is not intended that [participation in renegotiation] should have the effect that it [the modifying member] should have to pay compensation or suffer retaliation greater than the withdrawal of modification sought, judged in light of the conditions of trade at the time of the proposed withdrawal or modification.¹⁰⁴

The *Ad note* is a restatement of the principles of reciprocity and proportionality: If retaliation exceeds adjustment, the economic equilibrium is upset and the outcome unfair. A disproportionate response may work as an incentive not to modify commitments, but this is not what the WTO members intended; the provisions provide for absolute rights which are not to be unduly hampered. The notions of reciprocity and proportionality therefore govern the response of affected members on two levels: *Firstly*, reciprocity is largely the reason why affected members are permitted to respond. *Secondly*, reciprocity and proportionality are then used to moderate and discipline the response of affected members.

Despite these guidelines, there is still room for disagreement as to whether the proposed retaliation will disturb the previous equilibrium.

3.4.4 Against Which Members May Affected Members Retaliate?

A unilateral modification must be made on a MFN basis – it may not discriminate between its trading partners.¹⁰⁵ The AB has also clarified that the MFN principle applies to compensatory commitments agreed upon during

¹⁰³ Art. XXI:4(b) GATS. A reason for including this clause may be that it essentially eliminates the need to call on a panel to determine whether retaliation is “substantially equivalent” to the commitments withdrawn. This may prove necessary in the GATT.

¹⁰⁴ *Interpretative Note Ad Article XXVIII paragraph 1*, para. 6. The *travaux préparatoires* stressed that “we want any such exercise [retaliatory modification] to be limited to what is corresponding and not to be used in a punitive way”, see EPCT/TAC/PV/14, p. 20.

¹⁰⁵ The term MFN is used in this context to describe that the modification is implemented against all WTO members on a non-discriminatory basis. This is not the ordinary usage of the term, according to which any advantage granted to products or services originating in one country, must immediately and unconditionally be accorded to the like products or services of all WTO members.

renegotiation.¹⁰⁶ A more disputed question is whether retaliatory modification default of compensatory commitments may be implemented vis-à-vis the modifying member only, on a bilateral basis, or whether it too must be implemented vis-à-vis all members, on an *erga omnes* basis.

The GATS prescribes explicitly that retaliatory modification may be implemented “solely with respect to the modifying Member”.¹⁰⁷

The equivalent GATT provision does not address this question. It could be argued that the MFN principle in Article I GATT must then apply. However, an examination of the wording suggests that this is not obvious. The principle refers to “any advantage, favour, privilege or immunity”. Upon retaliation by an affected member, the modifying member is accorded neither, and retaliation on a MFN basis, rather than internationalizing an advantage, would simply spread a disadvantage which the modifying member has agreed to pay for.

A contextual interpretation implies that retaliation should be done on a bilateral basis: *Firstly*, the yardstick for renegotiation is that the parties should “endeavour to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade”.¹⁰⁸ This wording reflects not only an obligation to the economic equilibrium, but also to the general level of trade. Unilateral modification and consequent retaliation on a bilateral level is arguably less harmful to trade than if retaliation were to be done on an *erga omnes* basis. *Secondly*, GATS explicitly prohibits retaliation on an *erga omnes* basis. This may, with regard to GATT, be interpreted in two ways: The fact that GATS explicitly prohibits *erga omnes* retaliation, and GATT does not, may be interpreted *a contrario* to signify that *erga omnes*

¹⁰⁶ EC – Poultry (AB); EC – Poultry (panel). Brazil argued that the MFN principle did not apply to tariff-rate quotas resulting from compensation negotiations under Art. XXVIII GATT. The panel rejected this argument and held that this view “would create a serious loophole in the multilateral trading system. Such a result would fundamentally alter the overall balance of concessions Article XXVIII is designed to achieve”, cf. para. 215. The AB agreed that a tariff-rate quota resulting from Article XXVIII-negotiations must be administered in a non-discriminatory manner: “We see nothing in Article XXVIII to suggest that compensation negotiated within its framework may be exempt from compliance with the non-discrimination principle”, cf. para. 100.

¹⁰⁷ Art. XXI:4 GATS.

¹⁰⁸ Art. XXVIII:2 GATT; XXI:2 GATS (the wording in GATS is “commitments”).

retaliation is indeed permitted under GATT. Contextually, however, the fact that GATS prohibits *erga omnes* retaliation supports an equal interpretation of GATT. Considering the similarities between the GATT and GATS provisions, and the fact that Art. XXI GATT was modelled after Art. XXVIII GATT, the latter interpretation is sounder. *Finally*, retaliation as permitted by Art. 22 DSU may only be done against the member maintaining an illegal measure, and not all WTO members.¹⁰⁹

Practice suggests differently: There are traceable incidents where the GATT/WTO member reacting to unilateral modification threatened to do so on an *erga omnes* basis.¹¹⁰ Also statements from the negotiation history supports the view that retaliation may be implemented *vis-à-vis* all members.¹¹¹ Retaliatory modification against only the modifying member may, moreover, lead to a fragmentation of the WTO system of market access commitments. Several scholars maintain that retaliation must be done on an *erga omnes* basis.¹¹²

Although the law is not clear, the practice may give rise for concern: If an affected member retaliates on an *erga omnes* basis, innocent bystanders have to pay a price for the modifying member's unilateral modification.¹¹³ *Erga omnes* retaliation may, moreover, lead to an endless circle of counter-retaliation which the current legal framework is ill equipped to deal with.¹¹⁴

¹⁰⁹ The fact that retaliation for violations may only be done against the member in breach, does not necessarily support a similar conclusion for retaliatory modification for two reasons: *Firstly*, retaliation in DS is against an illegality; *secondly*, and importantly, retaliation in DS is a temporary measure, whereas retaliatory modification is permanent. Hudec maintains that "GATT/WTO rules should be interpreted to require that all permanent trade measures be made on an MFN basis", Robert Hudec, *Broadening the Scope of Remedies in WTO Dispute settlement*, in Friedel Weiss & Jochem Wiers, eds, *Improving WTO Dispute Settlement Procedures* 345 (2000), note 39.

¹¹⁰ The 1990 arbitration award on *Canada /EC – Article XXVIII Rights* recognized that Canada, the party affected by an EC modification, had the right to raise duties also *vis-à-vis* the rest of its trading partners on an *erga omnes* basis when retaliating against the EEC: "Should Canada exercise her right to withdraw concessions, she undertakes obligations to compensate third countries having negotiated rights in respect of Canada for the products on which concessions would be withdrawn". See DS12/R, 37S/80, p. 86; *Analytical Index*, *supra* note 48 at 875.

¹¹¹ EPCT/TAC/PV/18, p. 44: "[i]t is probably not desirable to carry it beyond the stage of original action and countermeasures... If unfairness does result from the practical action of those measures, it will have to be sorted out by the [CONTRACTING PARTIES]".

¹¹² *Inter alia*, Hoda, *supra* note 7 at 95; Hudec, *supra* note 109 at 25. Other scholars disagree, see *inter alia* Mavroidis (2007), *supra* note 22 at 106, holding that "it should be the case that retaliating WTO members should do so only on a bilateral basis".

¹¹³ From the perspective of the bystander, this amounts to a violation of Art. II GATT, and it is questionable whether Art. XXVIII GATT was meant to condone such practices.

¹¹⁴ Arguably, Art. XXVIII GATT may not be available for renegotiations between *retaliating* members and innocent bystanders. Thus, negotiations, if at all, would have to take place in a legal void.

Finally, the prospect of counter-retaliation by innocent bystanders may work as disincentives for members wishing or needing to modify their commitments. This is not in conformity with the contracting parties' intention.¹¹⁵

4. UNILATERAL MODIFICATION AND DISPUTE SETTLEMENT

4.1 Introduction

WTO members affected by a unilateral modification of commitments are not only protected by the specific retaliation provided for in Art. XXVIII GATT and XXI GATS. Arguably, there is still the possibility of the non-violation complaint and, in cases where the procedural requirements are not observed, even the violation complaint. Finally, the scope of retaliatory modification may give rise to disagreement and dispute.

It may be questioned why the WTO has provided for specific retaliation, and still other possibilities. An explanation may be the different nature of the legal entitlements provided in Art. XXVIII GATT and XXI GATS.¹¹⁶ The subject of the provisions, concessions and commitments, are largely bilateral and reciprocal in nature, and may therefore be adequately protected by the 'rebalancing' provided in these provisions. The procedural entitlements, however, are owed to a larger group of members and are, moreover, particularly difficult to 'monetize' or quantify for the sake of rebalancing. It is hard to see how rebalancing can be achieved where positive, non-reciprocated commitments such as procedural rules are infringed upon.¹¹⁷

The possibility of retaliatory modification also raises questions as to the relationship between retaliation pursuant to modification provisions and retaliation following dispute settlement.

¹¹⁵ Mavroidis (2007), *supra* note 22 at 106-108.

¹¹⁶ The nature of WTO obligations and commitments will be examined in section 5.

¹¹⁷ Simon A.B. Scopp, *Revisiting the "Compliance-Vs.-Rebalancing" Debate in WTO Scholarship: Towards a Unified Research Agenda*, HEI Working Paper No: 29/2007, p. 18; Joost Pauwelyn, *Enforcement and Countermeasures in the WTO: Rules Are Rules – Toward a More Collective Approach*, 94 *American Journal of International Law* 335 (2000) (hereinafter Pauwelyn 2000), p. 342; John H. Jackson, *International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out"?*, 98 *American Journal of International Law* 109 (2004) (hereinafter Jackson 2004), p.121.

4.2 Retaliatory Modification and Retaliation in Dispute Settlement: Differences, Similarities and Consequences Thereof

Suspension of commitments (referred to as 'retaliation') is a measure that may be implemented as an answer to unilateral modification, but also in the event that the recommendations and rulings of DS panels and the AB are not implemented within a reasonable period of time.¹¹⁸ There are several differences between retaliation in the two different settings, but the similarities are striking.¹¹⁹

Retaliation differs firstly with regard to duration: Retaliation in DS is a *temporary measure*, whereas retaliatory modification of commitments is *permanent*.¹²⁰

Secondly, the *multilateral involvement and control* differs to a certain degree: In a disputed setting, unilateral behaviour in the determination that a violation has occurred, is prohibited.¹²¹ Retaliation in DS also requires the "*authorization of the DSB*".¹²² Furthermore, the level of retaliation may be referred to arbitration.¹²³ Retaliatory modification is generally determined unilaterally by the affected member. Some similarities exist, however: Art. XXVIII:4 GATT requires the involvement of the CONTRACTING PARTIES.¹²⁴ Also, for services, affected members must participate in arbitration in order to retaliate, and must retaliate in conformity with those findings. The difference in multilateral involvement may possibly be explained by differences in regulatory aims: Whereas the modification provisions are intra-contractual, permissible,

¹¹⁸ Art. 22.1 DSU.

¹¹⁹ The negotiating history suggests that the original GATT DS article was entangled or merged with what is now the escape clause (Art. XIX GATT). However, the two were distinctly separated in the drafting process.

¹²⁰ In DS, retaliation does not end the matter. It is a temporary instrument to achieve the ultimate goal of compliance or mutually agreed settlement. Suspension is not a permanent rebalancing of concessions, as in renegotiations, but a temporary solution that must be ended if WTO rulings are implemented or a settlement reached.

¹²¹ Art. 23.2 DSU.

¹²² Art. 22.2 DSU. Since the DSB decides on such request by reverse consensus, the granting of authorization is automatic.

¹²³ Art. 22.6 DSU.

¹²⁴ In Art. XXVIII:4 GATT, the involvement of the CONTRACTING PARTIES is as follows: (i) They must authorize the modifying member to enter into renegotiations; they may prescribe the time-line for renegotiations; the matter may be referred to the them; they may upon such referral submit their views; and they may determine that the modifying member has failed to offer adequate compensation. The CONTRACTING PARTIES also determine which members have principal supplying interests, cf. Art. XXVIII:1. The CONTRACTING PARTIES decide by consensus, as opposed to the negative consensus in DS.

flexibility mechanisms, DS is concerned with enforcement of extra-contractual behaviour.¹²⁵

Thirdly, in DS, the choice of the object of retaliation is subject to principles and procedures, e.g. for cross-retaliation. The choice of retaliatory modification is, on the other hand largely non-regulated.¹²⁶

Finally, retaliation following a unilateral modification may be implemented almost instantly and, indeed, must be implemented within a certain period of time.¹²⁷ In DS, the member in breach may have a “*reasonable period of time*” to implement the recommendations and rulings, and retaliation may only occur after the expiry of this time.¹²⁸ The reasonable period of time may be significant.

As to the similarities, the level of retaliation in DS shall be “*equivalent*” to the level of nullification or impairment.¹²⁹ According to Art. XXVIII GATT and XXI GATS, the retaliatory modification shall be “*substantially equivalent*”. While the WTO has set more ambitious goals concerning DS than the GATT, the one WTO/GATT instrument to achieve those goals has been weakened, from “*appropriate*” retaliation (Art. XXIII GATT) to “*equivalent*” retaliation (Art. 22.4 DSU).¹³⁰ Somewhat surprisingly, intra- and extra-contractual behaviour may be remedied in essentially the same way. The WTOA thereby nearly reduces the distinction between lawful and prohibited behaviour to legalistic formality,

¹²⁵ Schropp, *supra* note 117 at 27, sorts GATT and GATS provisions into three levels: The *primary* rules comprise of substantive obligations in the form of market access commitments, and contracting provisions aimed at maintaining and stabilizing the initially agreed-upon level of bilateral cooperation (non-discrimination, prohibition of quantitative restrictions etc.). The *secondary* rules lay down how, and how rigidly, an initial concession is to be protected from *ex post* discretion. Art. XXVIII GATT and XXI GATS would fit in such category. While the primary and secondary rules delineate *intra-contractual*, permissible, behaviour, the *tertiary* rules accord how to sanction *extra-contractual*, uncooperative behaviour.

¹²⁶ The difference may be less than what it appears to be. Since the DSU deals with the multitude of the WTO Agreements, issues like cross-retaliation needs to be regulated. This is less necessary for retaliatory modification within one and the same agreement, although questions of cross-retaliation may arise for retaliatory modification as well, see below in section 4.4.

¹²⁷ Cf. e.g. Art. XXVIII:3 GATT: “*after 30 days*”, “*no later than six months*”.

¹²⁸ Art. 22.2 DSU.

¹²⁹ Art. 22.4 DSU.

¹³⁰ Joost Pauwelyn, *How Binding Are WTO Rules? A Transatlantic Analysis of International Law*, Presentation at Tübingen University 14-16 October 2004 (hereinafter Pauwelyn 2004), p. 14. The WTO has led to an increased possibility of retaliation in DS, given that retaliation became automatic in the sense that there is no need for consensus. In return, however, the *level* of retaliation seems to be lower.

Arguably, too much is now expected from retaliation: It is seen as an instrument to rebalance, to compensate, to induce compliance/settlement and to deter future violations.

leading to several potentially negative results: *Firstly*, a member may wish to violate its obligations rather than engaging in renegotiations pursuant to Art. XXVIII GATT or XXI GATS. Indeed, due to the similarities of the remedies and the fact that retaliation in DS is not immediate, violation may be penalized *less* than if the member resorts to the *de iure* flexibility mechanisms.¹³¹ *Secondly*, the similarity of the remedy has also contributed to confusion as to the object and purpose of DS.¹³² This is dealt with in Section 5.

4.3 Non-Violation and Retaliatory Modification

It is argued above that affected members which may not retaliate must avail themselves of the non-violation complaint.¹³³ The non-violation complaint, as conceived by drafters and applied by the members, serves to protect the balance of tariff concessions:¹³⁴

[The purpose of XXIII:1(b) is] to protect the balance of concessions under GATT by providing a means to redress government actions not otherwise regulated by GATT rules that nonetheless nullify or impair a Member's legitimate expectations of benefits from tariff negotiations.¹³⁵

Indeed, the object and purpose, as described by the GATT panel in *Oil Seeds*, also resemble those mentioned above in section 2:

[T]he idea underlying [XXIII:1b] is that the improved competitive opportunities that can be legitimately expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. In order to encourage contracting parties to make tariff concessions they must therefore be given a right of redress when a reciprocal concession is impaired by another contracting party as a result of the application of any measure, whether or not it conflicts with the General Agreement.¹³⁶

¹³¹ Schropp, *supra* note 117 at 41.

¹³² Pauwelyn, *supra* note 130 at 19; Schropp, *supra* note 117 at 26.

¹³³ Cf. section 3.4.2 above. The non-violation complaint follows from Art. XXIII:1(b) GATT and 26 DSU.

¹³⁴ Ernst Ulrich Petersmann, *The GATT/WTO Dispute Settlement System, International Law, International Organizations and Dispute Settlement* (1997), p. 173.

¹³⁵ *Japan – Film* (panel report), para. 1050.

¹³⁶ *EEC – Oilseeds*, para. 144. According to the panel, not only flexibility, but also security, encourages members to make commitments.

There is no obligation to withdraw the non-violating measure. Rather, the panel or AB shall recommend that the member concerned make “a *mutually satisfactory adjustment*”.¹³⁷ Although the text is not entirely clear, the adjustment may potentially involve retaliation. Thus, retaliation in both non-violation complaints and in the case of unilateral modification may be regarded as a final settlement: Under Art. XXVIII, the modifying member may permanently maintain the unbound concession for which retaliation is compensatory adjustment. This also seems to be the end-effect in non-violation cases, because the respondent is neither required to withdraw the measure or offer compensation, thus leaving retaliation as a response that will end the matter should the respondent choose not to remove the measure.¹³⁸

The similarities between the non-violation complaint and unilateral modification support Ernst Ulrich Petersmann's contention that “*non-violation complaints supplement GATT Article XXVIII as well as GATS Article XXI and serve to prevent their circumvention*”.¹³⁹

4.4 Modification in a Disputed Setting

Following the DS proceedings in *US – Gambling*, the US notified the WTO of its intention to exclude cross border internet gambling and betting services from its schedule of commitments pursuant to Art. XXI GATS.¹⁴⁰ This is the first case in which GATS schedules are modified in a disputed setting.

In relation to the GATT, modification of schedules in a disputed setting is not unheard of. The EC withdrew concessions after an unfavourable ruling in *EC – Poultry*, and the reconvened panel in *EEC – Oilseeds II* considered that an

¹³⁷ Art. 26.1(b) DSU.

¹³⁸ Hudec, *supra* note 109 at note 39.

¹³⁹ Petersmann, *supra* note 134 at 173.

¹⁴⁰ It is interesting to note that the US does not speak of modification but of clarification of concessions because, according to the US, it had never intended to include internet gambling when offering full commitments for recreational services, an argument which the AB did not buy, thus confirming the binding nature of commitments, cf. *US – Gambling* (AB), para.160.

appropriate way to eliminate the impairment of a tariff concession was to enter into a renegotiation of the tariff concession under Article XXVIII.¹⁴¹

There is little doubt that, pursuant to the wording of GATS and DSU, the US has the right to modify its commitment, even in a disputed setting, provided that it follows the procedural requirements.¹⁴² Nevertheless, unilateral modification in a disputed setting raises several questions, e.g. whether the US' recourse to Art. XXI GATS precludes retaliation under Art. 22 DSU, whether Antigua may still cross-retaliate under Art. XXI GATS and whether the US' recourse to Art. XXI GATS may be considered an act in bad faith, or infringes Antigua's legitimate expectations. The questions will remain unanswered here.

5. UNILATERAL MODIFICATION AND THE NATURE OF WTO COMMITMENTS AND OBLIGATIONS

5.1 Setting the Stage: The Compliance vs. Rebalancing Debate

For over a decade, a debate has been simmering among WTO scholars which at face value concerns the object and purpose of enforcement of WTO rules and the legal bindingness of dispute settlement reports. The debate was triggered by an editorial comment by Judith Hippler Bello:

Like the GATT rules that preceded them, the WTO rules are simply not 'binding' in the traditional sense... The only sacred, inviolable aspect of the GATT was the overall balance of rights and obligations, of benefits and burdens, achieved among members through negotiations... To put it simply, a government could renege on its negotiated commitment not to exceed a specified tariff on an item, provided it restored the overall balance of GATT concessions through compensatory reductions in tariffs on other items... The WTO substantially improved the GATT rules for settling disputes but did not alter the fundamental nature of the negotiated bargain among sovereign member states... The only sacred WTO imperative is to maintain that balance so as to maintain political support for the WTO Agreement by members.¹⁴³

¹⁴¹ *EEC – Oilseeds II* (GATT panel), para. 92. The difference between *US – Gambling* and *EC – Poultry* is reportedly that the EC modified its commitments only *after* having formally complied with the panel's and AB's ruling.

¹⁴² Pauwelyn, *WTO Condemnation of U.S. Ban on Internet Gambling Pits Free Trade Against Moral Values*, ASIL insights, November 2004, argued that "[i]f necessary, the United States can always renegotiate its GATS commitments and withdraw the one on internet gambling... All it needs to do is offer equivalent compensation or accept reciprocal trade retaliation by Antigua".

¹⁴³ Hippler Bello, *The WTO Dispute Settlement Understanding: Less is More*, 90 *American Journal of International Law* 416 (1996) (hereinafter Bello 1996), p. 417.

In an answer to Hippler Bello's editorial comment, John Jackson refuted her views and argued that WTO obligations, in the context of a dispute settlement ruling, are legally binding.¹⁴⁴

It soon became obvious that the two commentators' contentions were representative of two schools of thought, the 'rebalancing' and the 'compliance' schools.¹⁴⁵ The discord has also been termed "*property vs. liability rules*".¹⁴⁶

In generalizing terms, *rebalancing* scholars maintain that a WTO member may choose not to come into compliance with its WTO obligations – preferring instead to provide compensation or suffer retaliating.¹⁴⁷ The *compliance school* contends that the objective of WTO enforcement is to induce strict and prompt compliance with WTO obligations, and to deter future violations.¹⁴⁸ A third perspective, *inalienability*, views WTO as a global trade constitution, protected by an unconditional rule of immutability, which ties the hands of trade policy makers who may otherwise be tempted to heed to domestic protectionist pressure.¹⁴⁹

¹⁴⁴ Jackson, *The WTO Dispute Settlement Understanding - Misunderstandings on the Nature of Legal Obligations*, 91 American Journal of International Law 60 (1997) (hereinafter Jackson 1997), p. 60-64.

¹⁴⁵ Schropp, *supra* note 117 at 5.

¹⁴⁶ *Ibid*, at note 5.

¹⁴⁷ Judith Hippler Bello, *Book Review*, 95 American Journal of International Law 984 (2001) (hereinafter Bello 2001), p. 986-987.

The **rebalancing** school is rooted in a conviction that the WTO consists of reciprocal promises of market access, giving rise to an overarching balance of rights and obligations. The WTO is accordingly best conceptualized as a "web of bilateral equilibria", and enforcement of WTO obligations is equivalent to restoring the balance of commitment level in case the equilibrium is disturbed, cf. Schropp, *supra* note 117 at 7.

Rebalancing scholars tend to draw from the discipline of law and economics, and some utilize analogies from American economic theory of private commercial contracts. In contract theory parlance, rebalancing reflects a '**liability rule**' perspective on *ex post* escape from contractual obligations. Under a pure liability rule, the promisor wishing to deviate from its obligations may do so without the permission of any adversely affected promisee, but is liable for the damage as a result, see Schwartz & Sykes, *supra* note 6 at 182; Calabresi & Melamed, *Property Rules, Liability Rules and inalienability: One view of the Cathedral*, 85 Harvard Law Review (1972), p. 1092-93; Kaplow & Shavell, *Property Rules versus Liability Rules: An Economic Analysis*, 109 Harvard Law Review (1996), p. 715.

¹⁴⁸ The **compliance** school is deeply rooted in the discipline of public international law, and scholars rely mainly on treaty interpretation. For compliance advocates, the permissible manner of *ex post* escape from contractual obligations is via renegotiations under the purview of provisions like Art. XXVIII GATT, Art. XXI GATS and Art. X WTOA.

In contract theory parlance, the compliance perspective reflects a '**property rule**', whereby the parties to a contract are under a strict obligation to perform, and a failure to do so will be punished severely. However, the promisor can still avoid its commitments by securing permission from the promisee, usually by paying for it, see Schwartz & Sykes, *supra* note 6 at 182; Kaplow & Shavell, *supra* note 147 at 715; Schropp, *supra* note 117 at 12-13. The term 'property rule' comes from analogy to tangible property rights.

¹⁴⁹ Inalienability acknowledges that there are other stakes in the system than merely state interests. The predictability and stability of the world trading system advantages also non-state actors who are normally under-represented in the domestic trade policymaking, cf. Schropp, *supra* note 117 at 33-34

The existence of provisions allowing members to unilaterally modify their commitments has been used as an argument by the rebalancing school of thought¹⁵⁰, and gives rise to questions as to whether WTO obligations, in general, and WTO commitments, in particular, are binding. This section examines the nature of WTO obligations and commitments in light of the debate.

5.2 The Right to Unilaterally Modify Commitments Does Not Change the Binding Nature of WTO Obligations

The argument of the rebalancing school that WTO obligations are simply not binding, suffers from one major weakness: It draws conclusions on the binding nature of all WTO entitlements on the basis of the intra-contractual flexibility that is *explicitly agreed upon* for market access commitments.

The flexibility provided by Art. XXVIII GATT and XXI GATS is limited by the explicit wording to two categories of WTO entitlements: WTO members may unilaterally modify GATT “concessions” and GATS “commitments”. According to the AB, the ordinary meaning of the terms suggests that “*a member may yield rights and grant benefits, but it cannot diminish its obligations*”.¹⁵¹ A member cannot, then, reduce its other WTO obligations by unilaterally modifying its commitments pursuant to Art. XXVIII GATT and XXI GATS.¹⁵²

The rebalancing school reduces the WTO to a single-entitlement treaty in which reciprocal market access and liberalization commitments are exchanged. This perspective equates initially exchanged entitlements with other WTO obligations, and even the rationale for the WTOA. Rebalancing

¹⁵⁰ “Article XXVIII authorized trading partners to renegotiate tariff levels when local politics or a change in the domestic economy required it. The only sacred, inviolable aspect of the GATT was the overall balance...”, see Bello (1996), *supra* note 143 at 417.

¹⁵¹ *EC – Bananas III* (AB), para. 154; *EC – Poultry* (AB), para. 98; *US – Restrictions on Imports of Sugar* (GATT panel), para. 5.2.

¹⁵² Another reason why unilateral modification of market access commitments does not change the binding nature of WTO obligations is that the range of obligations that can be assumed through entries into schedules is limited. Members cannot include commitments which fall outside the legal framework of the GATT and GATS. GATT concessions must be accorded to “commerce” (Article II:1 GATT) while GATS commitments must be accorded to “trade in services” (Articles I and XVI GATS), see Nottage & Sebastian, *supra* note 31 at 995.

proponents are mistaken when equating the two: The WTOA comprises of more rights and obligations than solely the market access entitlement.¹⁵³

The GATT and GATS themselves are not simply a codification of commitments. In addition to the commitments that are annexed to these agreements, they contain a series of other obligations that together represent a code of conduct. Modifying a commitment does not make the other obligations any less valid: For instance, the commitments, renegotiation and unilateral modification must be administered in a non-discriminatory manner.¹⁵⁴ The AB saw “*nothing in Article XXVIII [GATT] to suggest that compensation negotiated within this framework may be exempt from compliance with the non-discrimination principle*”.¹⁵⁵ That the modification provisions do not make WTO obligations any less binding also finds support in the negotiation history:

[T]here is only a question here of withdrawal of concessions; there is no question of discriminatory measures against a particular country... this is, so to speak, a negotiation in reverse... the intent is clear: that in no way should this Article interfere with the operation of the MFN clause.¹⁵⁶

While a special and increased reciprocal relationship clearly exists with respect to market access commitments, essential other entitlements in the WTO legal order may not be explained as the result of an individual giving and taking as part of negotiations.¹⁵⁷ The WTO is a multi-entitlement agreement, and consists at least of (i) the reciprocal market access entitlements; (ii) minimum standards, which are owed to all members and inexplicable by the logic of reciprocal tariff concessions; and (iii) auxiliary entitlements, like procedural rules, transparency requirements and obligations owed to the institution itself.¹⁵⁸ WTO agreements such as the SPS or the TRIPS are unrelated to the idea of balancing trade concessions which are, like in

¹⁵³ Schropp, *supra* note 117 at 18, 20-21.

¹⁵⁴ Indeed, the obligations of non-discrimination apply regardless of whether or not obligations to liberalize exists in the relevant sector, see Stoll & Schorkopf, *supra* note 19 at 35.

¹⁵⁵ *EC – Poultry (AB)*, para. 100.

¹⁵⁶ *GATT Analytical Index*, *supra* note 48 at 874.

¹⁵⁷ Stoll & Schorkopf, *supra* note 19 at 48.

¹⁵⁸ Schropp, *supra* note 117 at 35.

the GATT and GATS, *additional* to the rules set out in the agreement itself. The rationale for adjustment of the bilateral-contractual balance of commitments has therefore become less relevant.¹⁵⁹ Indeed, many of the obligations in the WTOA are not dependent on the level of market access commitments at all. While some WTO obligations are concessionary, i.e. the subject of reciprocal exchange, others are absolute.¹⁶⁰ Thus, the binding nature of WTO obligations in general remains untouched by the possibility of unilateral modification of commitments.

Finally, the juridical alignment of the dispute settlement mechanism and the general prohibition of unilateral measures within the WTO have been understood as a step towards a more rule-oriented WTO. WTO members have not, by virtue of agreeing on provisions permitting unilateral modification, given up their right to challenge the consistency of modified schedules with the multilateral rules.¹⁶¹ There is also little doubt that WTO members are bound under international law by the WTO agreements.¹⁶²

The rebalancing school cannot be termed a complete theory on the binding nature of WTO obligations and enforcement. Rather, it is a theory about market access-related flexibility. When rebalancing scholars state that WTO rules are not binding in the traditional sense, they may actually intend to say

¹⁵⁹ Joost Pauwelyn, *The Nature of WTO Obligations*, Jean Monnet Working Paper (1/2002) (hereinafter Pauwelyn 2002), p. 35. The fact that negotiating WTO agreements continue to be a balancing exercise of give and take – in which, e.g., developing countries accept the TRIPS in exchange for agreements in agriculture and textiles – does not warrant a continued and exclusive focus on bilateral balances.

¹⁶⁰ Carmody, *supra* note 14 at 5. Another way to view WTO obligations is the distinction between reciprocal and integral obligations. To affect or alter a bilateral relationship does not normally impinge on other bilateral relationships, and their breach can only be invoked by the member(s) at the other end of the reciprocal relationship. The binding effect of integral obligations, of which there are many in the WTO, on the other hand, is collective in nature. To affect or alter an integral norm will necessarily have an impact on all members bound by that norm, see Pauwelyn, *supra* note 159 at 12. Market access commitments may be viewed as the former kind of obligation, non-discrimination as the latter. That may be an additional reason why modification of a member's MFN obligation requires a waiver, whilst market access commitments may be modified unilaterally.

The new issues areas of the WTO, like TRIMS, TRIPS, ILP may be seen as accords based on motivation quite distinct from the reciprocal exchange of market access. They have a multilateral ambit. They reflect not a quid pro quo, but are owned by the entire membership. As an example, the non-establishment of a functioning patent office impairs the competitive opportunities of *all* other members.

¹⁶¹ Mavroidis (2007), *supra* note 22 at 113.

¹⁶² Jackson (1997), *supra* note 144 at 60; Stoll & Schorkopf, *supra* note 19 at 40.

The obligation to comply with WTO rules reflects the principle of *pacta sunt servanda*. From an inalienability perspective, compliance also protects the stakes of the economy and the private operators affected by the system, see Thomas Cottier & Matthias Oesch, *International Trade Regulation: Law and Policy in the WTO, the European Union and Switzerland* (2005), p. 125. This view is not without controversy.

that previously negotiated *market access commitments* are not strictly binding, and are protected by a liability rule of flexibility. This may be a "*different ballgame*", and an important qualification in the applicability of the rebalancing perspective.¹⁶³

5.3 Are Market Access Commitments Binding?

Since market access commitments may be modified unilaterally, this triggers the question of whether commitments are binding.

In an article jointly authored by Warren F. Schwartz and Alan O. Sykes, the economic theory of contract remedies is applied to the renegotiation provisions and dispute settlement.¹⁶⁴ Schwartz and Sykes conclude that market access commitments are ultimately protected by a 'liability rule':¹⁶⁵ A member may modify its commitments unilaterally, but is liable for the modification. The liability is specified as the retaliation by affected members of "*substantially equivalent*" commitments.¹⁶⁶ The authors believe that the members have ultimately agreed on a liability rule out of "*the desire to facilitate efficient breach and in the relative superiority of a liability rule to approach that task*".¹⁶⁷

Both the *method* and *results* of the authors may be subjected to critical discussion.¹⁶⁸ Since WTO members have explicitly agreed on permitting

¹⁶³ Schropp, *supra* note 117 at 21–22.

¹⁶⁴ The theory proposes that a key objective of an enforcement system is to "*induce a party to comply with its obligations whenever compliance will yield greater benefits to the promisee than costs to the promisor, while allowing the promisor to depart from its obligations whenever the cost of compliance to the promisor exceed the benefits of the promisee (...) the objective is to deter inefficient breaches but to encourage efficient ones*", Schwartz & Sykes, *supra* note 6 at 181; Robert Cooter & Thomas Ulen, *Law and Economics* (2000), chapters 5 and 6.

¹⁶⁵ Schwartz & Sykes, *supra* note 6 at 187.

¹⁶⁶ The authors note that "*the system consistently employs liability rules rather than property rules*" and that the renegotiation provisions "*stop short of creating a property rule*", *ibid* at 183, 185.

Schropp, *supra* note 117 at 26 states that Art. XXVIII:3 GATT "*effectively renders the previous renegotiation clause futile*". This reflects neither the wording nor sequencing of the procedural requirements, nor the actual application of the provision by members.

¹⁶⁷ Schwartz & Sykes, *supra* note 6 at 187.

¹⁶⁸ Concerning **method**, Jackson(2004) warns against overstraining analogies from domestic private law jurisprudence and of incorporating them into the international law context, since parties of interest, institutional settings and contextual circumstances are usually so fundamentally different, *supra* note 117 at 111. Several concerns may be raised:

Firstly, economic models of contractual relationships assume extremely simplistic game settings, usually featuring two and not 153 parties, one and not multiple entitlements, and a stationary contracting environment. Reality is largely abstracted from. By comparing the WTO to simple sales contracts, explanatory scope may be lost and wrong inferences made, see Schropp, *supra* note 117 at 16-17.

unilateral modification, the *value* of examining efficient breach may be limited, and must at any rate be done by incomplete contract theory which gives rise to concern as to the accuracy of the results. Nonetheless, used cautiously, contract theory *may* provide insights into the optimal protection of market access commitments, and may provide insights into making renegotiation and unilateral modification as efficient as possible.

While economic (and political economic) theory may explain the optimal *protection* of commitments, the bindingness of commitments must be a normative or legal question. Although the binding nature of commitments may be assessed by virtue of their legal protection and enforcement, this is not necessarily so. Rather, the legally binding nature of WTO rules must be distinguished from the agreed-upon flexibility mechanisms and the consequences entailed by breaching those rules.

Articles II:7 GATT and XX:3 GATS prescribe that the schedules of commitments are an “*integral part*” of the GATT and GATS. According to the AB, “[*schedules of commitments*] represent a common agreement among all members”.¹⁶⁹ The commitments are not seen as purely concessionary or bilateral-contractual, but rather as the result of the *common intention* of all WTO members.¹⁷⁰ Commitments are therefore in principle binding in the same sense as obligations deriving directly from the agreements.

Secondly, the participant/beneficiary differs: In a commercial contract, the participants and beneficiaries are most likely the same. By contrast, in the WTO, the parties are governments, whereas the potential beneficiaries may be traders and individuals, see Jackson (2004), *supra* note 117 at 118-119. Of course, governments may heed their interests, but there is a difference between public choice and rational choice.

Thirdly, rebalancing proponents use an inconsistent terminology. Indeed, terms like breach, violation and enforcement are used in a cooperative, intra-contractual context, see Schropp, *supra* note 117 at 21.

Concerning **result**, Schwartz & Sykes underplay the important ‘property rule’-elements in the modification provisions. Both *de iure* and *de facto*, renegotiation is necessary and preferred. It should also be noted that the WTO members have significantly reduced the potential costs and hold-up problems that embracing a ‘property rule’ may have created. Moreover, it is questionable whether Art. XXVIII GATT encourages efficient adjustment, cf. Pauwelyn, *supra* note 130 at 36.

¹⁶⁹ EC – Computer Equipment (AB), para. 84.

¹⁷⁰ EC – Computer Equipment (AB), para. 84. EC – Poultry (AB), para. 82; Canada – Dairy (AB), paras 131-133; Korea – Beef (AB), paras 96-97; US – Gambling (AB), para. 160.

Moreover, between the open seasons for renegotiation, the firm validity of GATT concessions is affirmed.¹⁷¹ A member is required to fulfil its obligations notwithstanding any deterioration of its economic conditions, hardship or *force majeure* during the stipulated time period.¹⁷²

The fact that commitments may be changed at the will of any member, does not make the commitments any less binding for one additional reason; unilateral modification is explicitly agreed upon and provided for in the GATT and the GATS. In other words, unilateral modification is a conduct which is expressly governed by the WTO legal order and is mirrored by respective procedures and instruments as provided by the WTO agreements.¹⁷³ Within this set of rules, it is then up to the members to decide whether and when to engage in renegotiations, and any bargains struck are implemented subject to these rules.¹⁷⁴ If commitments were not legally binding, there would be no reason to include the provisions permitting renegotiation and unilateral modification. Indeed, rather than diminishing the binding nature of commitments, the provisions permitting unilateral modifications confirm their binding nature. The provisions would not be necessary if freedom to unilaterally modify the commitments existed anyway.

Whereas international trade rests on comparative costs and benefits, the foundation of international trade law is, in the last resort, the categorical imperative of *pacta sunt servanda*.¹⁷⁵ Unilateral modification of market access commitments is expressly agreed upon, and does not diminish the binding nature of the commitments themselves or other WTO obligations.

¹⁷¹ This does not apply to the GATS commitments, which may be modified at any time after three years have lapsed since the entry into force of the commitment, see section 3.3.2 above.

¹⁷² M Rafiqul Islam, *International Trade Law of the WTO* (2006), p. 364-365. It may even be questionable whether the public international concept of *rebus sic stantibus* is available to the members. However, the member in question may have reserved the right to modify its commitments or be granted this opportunity by the WTO members in "special circumstances", see Article XXVIII:4 and 5.

¹⁷³ Stoll & Schorkopf, *supra* note 19 at 41.

¹⁷⁴ Bagwell & Staiger, *supra* note 28 at 48.

¹⁷⁵ Benedek, *supra* note 45 at 10.

5.4 Returning to the Stage: Concluding Remarks on Rebalancing and Compliance

If one isolates multilateral entitlements from reciprocal market access commitments, rebalancing and compliance may be seen as complementary. Rebalancing is, indeed, provided for in the renegotiation provisions. Compliance, on the other hand, should be the central element of extra-contractual enforcement. The market access commitments may be optimally protected by a liability-type rule. Nonetheless, the fact that both GATT and GATS provide for flexibility for these entitlements, does not change the binding nature of WTO commitments or obligations.

Rather than having to choose between compliance or rebalancing, property or liability rules, a way forward may be to agree on when compliance is the optimal goal and when liability protection is more suitable, depending on the WTO obligations in question.¹⁷⁶

6. CONCLUSION

Rules on market access are at the core of WTO law. Largely varying tariff schedules and schedules of commitments in services construct the backbone of the world trading system.¹⁷⁷ While market access commitments agreed on the liberalization of trade in services are modest, over 80.000 tariff lines have thus far been bound. Members can therefore, by modifying commitments, unilaterally increase or reduce a broad range of rights and obligations in WTO law. As entries in schedules tend to be member-specific, members may flexibly tailor their commitments to their circumstances and interests.

Yet, before the completion of the Uruguay Round, renegotiation of commitments occurred every year with respect to some 100 items on average, as compared to the 80.000 tariff lines bound. During 1951–1994, 42 contracting parties availed themselves of the renegotiation option some 300

¹⁷⁶ Pauwelyn, *The Calculation and Design of Trade Sanctions in Context: What is the Goal of Suspending WTO Concessions*, Working Paper presented at the Interdisciplinary Workshop on the Calculation and Design of Trade Sanctions in WTO Dispute Settlement, Graduate Institute of Geneva, note 58.

¹⁷⁷ Thomas Cottier, *From Progressive Liberalization to Progressive Regulation in WTO law*, 9 *Journal of International Law* 779 (2006), p. 820.

times. After the completion of the Uruguay Round, only 34 requests for modification have been made.¹⁷⁸ In the absolute minority of these cases was there the need to proceed unilaterally.

The mechanisms for – and disciplines on – modification of market access commitments are nevertheless without question important to the WTO members. Sometimes, the political cost of maintaining a bound commitment is perceived by members as too large. For instance, following the dispute settlement proceedings in *US – Gambling*, the US may deem it necessary to proceed unilaterally following arbitration. The provisions providing members the possibility to unilaterally modify their legally binding commitments are therefore essential flexibility mechanisms, which facilitate realities encountered in the member states, while serving the process of progressive liberalization.

¹⁷⁸ Table of goods schedules, available at the website of the WTO: http://www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm (visited 20 December 2008).